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BUDGET 2016: Economic Commentary

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This document provides commentary and summary of the main changes announced in the Budget Tuesday 13th October 2015.

Irish Budget Economic Commentary

For a second year running, the economic and fiscal backdrop in Ireland is much more favourable than official projections made at the time of the most recent update of the medium term fiscal plan in the Stability Programme Update in early April this year.

This is evident in the pre-budget growth projections provided by the Department of Finance in early October on which the budget was based. In these, GDP growth was forecast at 6.2% in 2015 and 4.2% in 2016 compared to the estimates in April of 4.0% growth in 2015 and 3.8% in 2016. This reflects the strong performance in the Irish economy year to date with GDP rising 6.7% y/y in Q2 and a 7.0% rate in the first half following an upward revision to Q1 GDP to 7.2% y/y.

In Q2, domestic demand was strong as consumption grew 0.4% q/q or 2.8% y/y while investment rose 19.2% q/q or 34.2% y/y. The trade side continued to make a positive contribution with exports rising 6.3% q/q or 13.6% y/y in Q2 with the trade surplus set to rise for the first year since 2010. In Q2 the current account surplus rose to €2,704m or 5.2% of GDP. The economy and domestic demand have been underpinned by the continued fall in unemployment to 9.4% and the rise in numbers employed to 1.96m which is the highest since Q2 2009. Consumer confidence has risen close to nine year highs and retail sales remain strong, most recently up 9.3% y/y or 7.6% y/y excluding autos.

With the better than expected growth backdrop, the government fiscal position prior to the budget was significantly better than initially expected. To the end of September, the underlying deficit was €2.4bn or 1.5% of GDP ahead of the 2.3% official target. Tax revenues were running 5.8% ahead of budget while government expenditure was €500m below target, mainly due to lower debt service costs as a result of low interest rates and lower than expected current expenditures.

However, in the White Paper published last weekend outlining revised forecasts for public finances, the government indicated that it intends to spend an additional €1.5bn compared to its previous target over the remainder of 2015, thus using much up much of the excess revenues generated year to date. As a result of the additional €1.5bn expenditure in 2015, the fiscal deficit for 2015 is now forecast to be 2.1% of GDP, higher than implied by the exchequer returns to the end of September.

The 2016 budget announced today was generally in line with expectations and included €1.5n of expansionary measures split 50/50 between reduced taxes and increased expenditure. The main tax reduction related to the increased entry threshold for the payment of the Universal Social Charge (USC) to €13,000 and a 0.5% reduction in USC rates to 1% and 3% for the first two bands and a 1.5% reduction to 5.5% for the third band. Other tax reductions included the removal of the pension levy of 0.15%, an increase in the threshold for capital acquisitions tax on transfer of family wealth to €280,000, a reduction in capital gains tax on the sale of businesses to 20%, reductions in commercial vehicle tax and introduction of tax credits for self-employed and small business owners and for farmers. The only tax increase announced related to a 50 cent increase in excise duty on cigarettes and tobacco products.

On the spending side, additional expenditure of €750m in 2016 will include initial spending under the recently announced capital spending plan of €27bn which will be implemented over six years. Other areas with increased funding next year include child care, education, social protection and housing and the health services. Extra spending will also be available for additional garda recruitment and public service wage increases.

Overall, the government estimated that the fiscal deficit will fall to 1.2% of GDP in 2016 with a balanced budget expected by 2018. Debt/GDP is estimated to fall to 97% by the end of 2015 and 93% by 2016 and was forecast to be below 80% by 2021. The government forecast that GDP will grow at around 3% in the years following 2016.